

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

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December 29, 2009

The Honorable Arnold Schwarzenegger
Governor of California
State Capitol Building
Sacramento, CA 95814

Dear Governor Schwarzenegger:

In accordance with the Financial Integrity and State Managers Accountability Act of 1983, Government Code Sections 13400 through 13407, I am submitting the enclosed report, Biennial Report on the Adequacy of Internal Accounting and Administrative Control, describing the review of our systems of internal control for the biennial period ended December 31, 2009.

Sincerely,

(Signed By: Lynn L. Jacobs)

Lynn L. Jacobs
Director

Enclosure(s)

Business, Transportation and Housing Agency



California Department of Housing and Community Development (Organization Code 2240)



Biennial Report on the Adequacy of Internal Accounting and Administrative Control

**In compliance with the
Financial Integrity and State Manager's Accountability Act of 1983**

December 31, 2009

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INTRODUCTION

In accordance with the Financial Integrity and State Manager's Accountability Act of 1983 (FISMA), the California Department of Housing and Community Development (HCD) submits this report regarding the review of our system of internal control for the biennial period ended December 31, 2009.

Should you have any questions please contact Charles Clark, Deputy Director of Special Projects and Accountability, (916) 324-7962, cclark@hcd.ca.gov.

BACKGROUND

Mission, Vision, Shared Values/Core Principles and Goals

HCD is the principal housing agency in California. Its mission, vision, shared values/core principles and goals provide direction and focus as HCD carries out its mission.

Mission
Provide leadership, policies and programs to preserve and expand safe and affordable housing opportunities and promote strong communities for all Californians.

Vision
Recognizing that housing is a basic element of a just and successful society, HCD will provide leadership towards achieving vibrant communities with quality, adequate housing for all Californians.

Shared Values/Core Principles
<p>Employees are our greatest asset.</p> <p>Customer satisfaction can only be achieved through the dedicated commitment of all employees to the accomplishment of the Department's mission. Every job, and the individual performing that job, is a vital component of the organization and each employee is highly valued as a professional and as a person. All supervisors and managers will support, educate, mentor, and provide every opportunity to gain satisfaction from a job well done. In short, we will all treat one another with the respect we each deserve as a valued and mission critical member of the organization.</p>
<p>Diversity is strength.</p> <p>California is an extraordinarily diverse state bringing together a vast pool of experiences, perspectives, and talents. The achievement of our mission and goals is best accomplished by having a workforce that reflects and represents this extraordinary diversity.</p>

Shared Values/Core Principles
<p>All work is done with honesty, integrity, and personal responsibility.</p> <p>Because we respect and value each other we will be models of the professionalism and responsibility we expect from others. We will do our best at all times and strive to do the right thing.</p>
<p>Work as one team to accomplish the Department's mission and goals.</p> <p>Working together as a team, close coordination among units and divisions will enable us to accomplish our goals and achieve success.</p>
<p>Continuously improve.</p> <p>We must always and continuously strive to find new and better ways to meet our customer's needs. Because technology and the economy are constantly changing, provided with information and resources, the creative energies of our employees can, and will, find ever more inventive and efficient ways to better serve our customers and to further our mission.</p>

Goals
<p>Goal One: Increase Housing Supply for all Californians</p> <p>Objectives:</p> <ol style="list-style-type: none"> 1. Develop housing standards, planning and land use policies that are cost-effective and sustainable. 2. Increase supply of affordable housing through all housing assistance programs for homeownership, rental and special needs populations including the homeless. 3. Improve infrastructure to facilitate housing development, especially infill (remove barriers). 4. Improve local implementation of Housing Element Law. 5. Strategically communicate need/benefits of housing supply.
<p>Goal Two: Establish a Permanent Funding Source for Affordable Housing</p> <p>Objectives:</p> <ol style="list-style-type: none"> 1. Identify and coordinate current efforts and "contract" with those parties for state/HCD to lead. 2. Identify a menu of potential source or sources (and amounts) of funds. 3. Identify effective program models and efficient methods of distribution. 4. Develop consensus on viable permanent funding source(s) and strategy to achieve it.

Goals
<p align="center">Goal Three: Maintain the Health and Safety of Existing Housing Stock</p> <p>Objectives:</p> <ol style="list-style-type: none"> 1. Improve the safety of Mobilehome Parks. 2. Improve maintenance standards for existing housing stock, including “aging in place” and sustainable construction practices. 3. Preserve existing affordable housing stock.
<p align="center">Goal Four: Strengthen Communities by Improving Infrastructure and Attracting, Expanding and Retaining Business and Jobs for Californians</p> <p>Objectives:</p> <ol style="list-style-type: none"> 1. Improve business focus and customer service in HCD programs. 2. Improve infrastructure throughout California, including rural areas and small communities. 3. Increase the effectiveness of the Enterprise Zone Program. 4. Increase public awareness and effective customer use of state/HCD economic development programs to improve local economies.

HCD Environment

The control environment sets the tone of an entity, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values, and competence of the entity’s people, management’s philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided.

Control Environment

The HCD control environment is set by the tone at the top, which continually conveys and demonstrates a commitment to high expectations, ethical standards and integrity. Contained in the Housing Administrative Manual (HAM) are policies and procedures regarding acceptable business practices, conflicts of interest and codes of conduct.

HCD management demonstrates its commitment to competence by establishing the level of competence needed for each job and translating that level into required knowledge and skills. Knowledge, skills and responsibilities are communicated to employees via clearly documented duty statements. These duty statements support the HCD commitment to competence by providing clear criteria for hiring, performance evaluation and promotions.

The management philosophy and operating style within HCD is goal oriented, strategically focused and mindful of potential program risks. Goals and objectives indicating what the Department desires to achieve are carefully considered and supported by related strategic plans. Performance toward goals and objectives are methodically

tracked and periodically reported to Executive and Agency management. Risks to the organization are taken very serious. An enterprise Risk Management Program exists to identify, assess and manage all risks to the organization through appropriate means (mitigation, acceptance, avoidance, transfer, etc.).

The HCD organizational structure is centralized with adequate supervision and monitoring of decentralized operations. Managers throughout the structure have the required knowledge, experience, skills and training to handle their responsibilities. Responsibilities and reporting relationships are clearly defined and effectively communicated to all managers.

Assignment of authority and responsibility within HCD flows from Executive and management delegation, and is based on the job responsibilities, knowledge and skills, and past performance of the manager or employee. Empowerment is accompanied by accountability and procedures for management to monitor results.

Human resource policies and procedures within HCD are documented in the HAM and in various applicable State laws and regulations. Policies and procedures are clearly communicated to all staff. In addition, HCD management makes all employees aware of their job responsibilities and expectations via duty statements and periodic performance evaluations.

Based on the control factors (Integrity and Ethical Values, Commitment to Competence, Management's Philosophy and Operating Style, Organizational Structure, Assignment of Authority and Responsibility, and Human Resource Policies and Procedures) evaluated, it can be concluded that a positive control environment exists in HCD.

Critical Business Functions, Objectives, and Activities

There are three major programmatic divisions within the Department that encompass the critical functions, objectives, and activities of the Department, summarized below.

- Division of Housing and Policy Development
- Division of Financial Assistance
- Division of Codes and Standards

Division of Housing Policy Development (HPD)

The mission of the Division of Housing Policy Development (HPD) is to administer, develop and advocate policies and laws to further housing and community development. It accomplishes this by identifying housing needs in California and developing policies to meet those needs. HPD also administers state housing research to facilitate housing development and improvement, including an annual report on redevelopment agencies' housing activities and provides a wide range of technical assistance to local governments, public and private housing providers, business and industry groups, housing advocates and interested citizens.

Division of Financial Assistance (DFA)

HCD administers more than 20 programs that award loans and grants for the construction, acquisition, rehabilitation and preservation of affordable rental and ownership housing, homeless shelters and transitional housing, public facilities and infrastructure, and the development of jobs for lower income workers. These loans and grants are made to local public agencies, nonprofit and for-profit housing developers, and service providers. In many cases these agencies then provide funds to individual end users. DFA also prepares and implements the federal consolidated planning and performance reporting requirements for HUD, ensuring California receives millions in federal housing and community development dollars.

Division of Codes and Standards (DCS)

The objective of this division is to provide protection for the public in areas of health, safety, and general welfare in buildings and structures designed for human occupancy through the enforcement of the relevant provisions of the California Health and Safety Code, including:

- State Housing Law,
- Employee Housing Act,
- Mobilehome Parks Act,
- Special Occupancy Parks Act,
- California Factory-Built Housing Law; and
- Mobilehome-Manufactured Housing Act of 1980.

The program also enforces federal and state standards for the construction, safety, sales, and titling of manufactured homes, mobilehomes, and commercial modulars.

VACANT POSITIONS

Government Code Section 12439 provides that departments abolish any position that is vacant for six consecutive monthly pay periods on the following July 1. Below is the list of positions that HCD abolished, consistent with this requirement, during the reporting period for this FISMA report.

Position#	Classification
205-1139-052	Office Technician
205-8789-062	Housing and Community Development Manager I
205-8962-002	Housing and Community Development Representative II
205-8962-006	Housing and Community Development Representative II
104-5778-033	Staff Counsel
206-8962-005	Housing and Community Development Representative II
211-8962-003	Housing and Community Development Representative II
211-8962-004	Housing and Community Development Representative II

RISK ASSESSMENT

During the period in question, HCD performed and drew upon the results from multiple risk assessments, reviews and strategies. An organizational-wide risk assessment was performed in 2008. In 2009, a reassessment was performed to identify any new or changed risks and validate risks previously identified in the 2008 risk assessment. In addition, an enterprise risk management program was implemented to provide ongoing identification and treatment of risks throughout the Department.

Risk Assessment Methodology

In an effort to get an accurate measurement of the "adequacy of (HCD) system of internal accounting and administrative control" the Department utilized a two-prong approach to reducing risk at HCD. One prong of the approach is the Risk Management Program, which continuously identifies and manages risks. The other prong was the development and execution of an enterprise risk assessment to identify and prioritize potential risk.

2008 Risk Assessment

The 2008 risk assessment used the following methodology.

Guiding Principles

In order to provide practical guidance and an authoritative framework for the development of the risk assessment methodology, HCD utilized the following principles:

- Consideration is given to unique situations and circumstances (i.e., special audits), which would supersede risks with higher risk scores.
- We recognize that audit resources are limited; this limiting factor is inherent in the concept of utilizing a risk assessment model to help prioritize risks.
- Work performed by other audit organizations is taken into consideration. These audits may be mandated by grant provisions, State and federal agencies, or special audits.
- The risk assessment criteria used in risk ranking, places an emphasis on perceived or actual knowledge of the HCD system of internal controls.
- There is an understanding that there are inherent limitations associated with any method or system of prioritizing risks.

Audit Population

The first step in developing the risk assessment model was to establish an audit universe representing the total population of potential audits and the associated risks. The audit universe consists of key administrative functions, program processes and "horizontally" cross-cutting issues that are common to the audit universe. The team started by using the HCD organizational chart to identify all divisions in the Department. Then instructional materials were prepared for the Deputy Directors of each division to help them understand the risk assessment process.

After the Deputy Directors had time to review and understanding the materials, the team met with them to answer any questions and address any issues that remained. In some

cases the team conducted workshops to go through the risk assessment process. In addition, the Directorate identified the cross-cutting risks that were common “horizontally” across the enterprise such as bond accountability, strategic planning, performance management, and staffing challenges.

Prioritization and Selection

Process

In developing the risk assessment model, the team agreed that risk is the potential for loss to HCD due to error, fraud, inefficiency, failure to comply with statutory requirement, or actions that may have a negative effect on the Department. Risk is a synonym for all the adverse outcomes that the Department wishes to avoid or positive opportunities the Department wishes to exploit. Risk is a function of probability, magnitude and likelihood.

The team recognized that risk assessment is a process of assigning a number or score to potential audit areas and their associated risks based upon specific risk factors related to operations in the Department. The team utilized a systematic risk assessment approach. This approach separates risk into individual factors, which were assessed individually, then combined into an overall score reflecting the risk potential in the Department.

Risk Factors

The individual risk factors used to evaluate the potential audit areas and their associated risks were selected by the team from personal professional experience with implementation of risk assessment models at other State departments, professional literature and other State governmental audit plans reviewed. The five risk factors are as follows:

- Potential Negative Political Exposure and/or Adverse Financial Impact To Funding Sources
- Changes – Related to the Strategic Plan
- Dollar Size, Transaction Volume and Asset Exposure
- Complexity and Volatility
- Prior Audits and Assessment of Internal Controls

Weighting Factor

The team also recognized the necessity to account for the relative measure of importance between each of the risk factors and the resultant impact on the overall risk score. Therefore a “weighting” factor was derived and applied to all risk score calculations.

Risk Assessment Results

Each audit area and its associated risks were ranked based upon highest to lowest total risk scores, thereby producing a prioritized listing. However, consideration is given to

unique situations and circumstances (i.e., preliminary reviews, special audits) that supersede items with higher risk scores.

2009 Risk Assessment

The 2009 risk assessment used the following methodology.

Understanding of Requirements

HCD Executive and senior management met with the Department of Finance (DOF) Office of State Audits and Evaluations management to gain a better understanding of the revised requirements for FISMA reporting. We were advised that the new requirements focused on having management identify the known risks in the Department with material inadequacies or weaknesses and without adequate controls. Based on the information provided during this meeting and from DOF literature, a revised assessment methodology was formulated.

Methodology

Results from the 2008 risk assessment were augmented by assessing and adding risk descriptions and potential risk deficiencies to each of the auditable activities. Using the updated document as a starting point, Executive and senior management were provided with risk assessment questionnaires and involved in risk assessment meetings to guide their analysis and assessment of all risks in their respective areas. Each auditable activity and its associated risks from the 2008 risk assessment were re-evaluated to determine if it posed a significant risk to the Department and was without adequate controls. In addition to re-evaluation of 2008 results, each area was tasked with identifying any new risks that met the same criteria; a known significant risk without adequate controls.

Risk Assessment Results

The risk assessment produced four significant known risks to HCD that were without adequate controls. For each risk that satisfied the criteria, a Risk Management Program form was used to document the risk and capture all the required information to permit tracking, corrective action planning and ultimate resolution.

Greatest Vulnerabilities

The greatest risks/vulnerabilities in the organization are the:

- Document Management System
- Consolidated Automated Program Enterprise System (CAPES)/California State Accounting and Reporting System (CALSTARS) Reconciliation
- Stable, Ongoing Funding Source(s) for Affordable Housing Programs
- Sunset of the Mobilehome Parks Maintenance Inspection Program

Focus of Review

The focus of the review was to involve each administrative and operational Deputy Director or Chief in a thorough self-assessment of their respective area, culminating in a detailed analysis of each perceived risk. Although program areas are typically

addressed, support areas such as the Legislative, Administration, Legal, and Equal Opportunity Offices may recognize or work on issues resulting from programmatic or other cross-cutting risks and were included in the risk review.

The broad focus of review provided reasonable assurance that if a material inadequacy or weakness existed in the organization, it would be identified for appropriate treatment.

Internal and External Audits Performed

This report submitted pursuant to FISMA is for the reporting period of January 1, 2008 through December 31, 2009. On September 8, 2009, Governor Schwarzenegger implemented Executive Order S-20-09, which directs departments to post audits, program reviews, monitoring and accountability reports, evaluations, inspections, assessments and studies on the Reporting Transparency in Government website. The following is the link to the website and the list of internal and external audits performed on the programs of the Department during the reporting period for this report (see Attachment 1).

http://www.reportingtransparency.ca.gov/Audits/External_Audits/Housing_and_Community_Development_Department_of/

http://www.reportingtransparency.ca.gov/Audits/Internal_Audits/Housing_and_Community_Development_Department_of/

The focus of this report is the identification of material risks in the Department. As stated earlier in risk assessment section of this document, the Department developed a methodology for determining the materiality of risks. None of the findings identified in the audits performed during the reporting period have been determined to be material in nature. Nonetheless, each finding has been addressed by the Department, including, where appropriate, a corrective action plan (see individual audits reports listed on the Reporting Transparency in Government website).

EVALUATION OF RISKS AND CONTROLS:

Document Management System

Condition/Issue

The Division of Codes and Standards uses an aging Document Management System that includes an obsolete juke box to store and manage critical permanent title record information. The Health and Safety Code §18080.7(c) provides that the Department shall establish or amend the permanent title record. The DCS operationalizes this requirement by retaining legal copies of many documents for up to 100 years.

In addition, the Division of Financial Assistance is required to maintain the original hardcopy of critical housing documents for 55 years in order to monitor and manage various housing related contracts for long-term projects. Current business processes

and service level agreements require that the documents be retrieved frequently; therefore they must be maintained onsite in close proximity to program staff. Storing the original documents onsite poses a significant risk in the event of fire, flood or other catastrophic event. Laws and regulation governing 55-year loans and associated document retention include:

- Health and Safety Code §50675.6(b)(1) (Multifamily Housing Program)
- Health and Safety Code §53562(b) (Transit Oriented Development)
- California Code Regulations §7211(a) (Serna)
- California Code Regulations §8208(a) (HOME)

Risk

The risk is that the current data storage and retrieval system in place is obsolete and cannot ensure that documents can be retrieved and reproduced as required by applicable laws and regulations.

CAPEX/CALSTARS Reconciliation

Condition/Issue

CALSTARS is an Accounting System administered by the Department of Finance for the entire State of California. CALSTARS is not designed for long term loan-accounting which is needed by HCD.

The HCD programs and reporting requirements have evolved, requiring more information to various stakeholders than CALSTARS by itself, is able to provide. The CAPEX system is a proprietary system administered and maintained by HCD, which was initially developed to maintain information at both program and contract levels, without being an accounting system.

These two systems were designed with different end results in mind. However, as the complexity of the reporting requirements grew, CAPEX was the system that could be expanded to accommodate new and complex reporting requirements. However, CAPEX is unable to provide reports that reconcile to CALSTARS.

Both systems are table driven, with both systems requiring manual input and reconciliation for accuracy. Because it is being used as a tool for management reporting and decision making, the CAPEX system should reconcile with the HCD official financial accounting system (CALSTARS). No provision has been designed for these two systems to communicate directly. If all contract information could be entered once (encumbrance, payment, disencumbrance, amendments, etc), and uploaded or downloaded to the other system, (communicating with each other) the risk of these two systems not reconciling and the associated problems would be minimized.

Risk

The fact that CAPEX and CALSTARS are not completely reconciled creates risk of errors in communication and decision making.

Stable, Ongoing Funding Source(s) for Affordable Housing Programs

Condition/Issue

According to statistics, the projected annual housing needs for California continue to outpace the number of housing units built annually. Proposition 46 (2002) and Proposition 1C (2006) are voter approved housing bonds that help narrow the housing gap and provide economic stimulus for California. The bonds provide money for a variety of housing programs for California families, including the construction, rehabilitation and preservation of affordable rental and owner-occupied housing, homeless facilities, and funding for down payment assistance to low and moderate income first-time homebuyers.

However, housing funds authorized by the housing bonds above will soon be depleted. Without a new influx of funding, effective State housing programs will not continue to provide affordable housing opportunities and stimulus for California's economy.

Risk

The State will not be able to continue providing resources to preserve and expand affordable housing opportunities/supply after current housing bonds are depleted.

Sunset of the Mobilehome Parks Maintenance Inspection Program

Condition/Issue

The California Mobilehome Park Maintenance Inspection Program codified by Health and Safety Code § 18400-18424 provides for the inspection of all mobilehome parks, their accommodations, equipment, or paraphernalia used in the operation of the park. The statute provides for the enforcement, issuance of violations and permits by HCD. Included in the statute is a sunset provision that will cause the program to sunset as of January 1, 2012. At that time, HCD will no longer have the authority to conduct these types of inspections or collect fees.

Risk

If the program sunsets on January 1, 2012, the Department will no longer have the authority or resources to inspect mobilehome parks. In addition, there are other general operating provisions which would be subject to the sunset provisions.

CONCLUSION:

The review identified four material inadequacies or weaknesses in the system of internal accounting and administrative control, but that will not prevent the Director from stating that the Department substantially complies with the intent of FISMA.

Attachment 1

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Reporting
TRANSPARENCY
In Government

[Home](#) -» [Audits](#) -» [Internal Audits](#) -» Housing and Community Development Department of

Internal Audits

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HOUSING AND COMMUNITY DEVELOPMENT DEPARTMENT OF

-» [2009 Jun - California Rural Demonstration Program Audit \(pdf\)](#)

Reporting
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External; Audits

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HOUSING AND COMMUNITY DEVELOPMENT DEPARTMENT OF

- » [2009 Nov - BSA Audit of Housing Bond Funds \(pdf\)](#)
- » [2009 Aug - Review of the State of California Allocation Formula for the Neighborhood Stabilization Program \(pdf\)](#)
- » [2009 Jul - Audit of the Department of Housing and Community Development for Compliance With State Business Management Policies \(pdf\)](#)
- » [2009 May - Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2008 \(pdf\)](#)